

This paper will be considered in public

1 Summary

- 1.1 This paper sets out the proposed TfL borrowing limits and other Prudential Indicators under the CIPFA Prudential Code (the Prudential Code), which are consistent with the proposed Treasury Management Strategy for 2014/15. These limits and indicators are based on figures in the 2014/15 TfL Budget, which is also included in this agenda.
- 1.2 Under the Prudential Code, TfL is required to adopt Prudential Indicators which support decision making on planned capital expenditure, borrowing and treasury management activities. The proposed Prudential Indicators for 2014/15, and the following two years are attached to this paper as Appendix 1. In line with guidance from CIPFA, Treasury Management Indicators are shown separately in Appendix 3.
- 1.3 At its meeting on 12 March 2014, the Finance and Policy Committee considered a similar paper and endorsed the recommendations to the Board.

2 Recommendations

- 2.1 **The Board is asked to note the paper and approve:**
 - (a) **revised limits for long term liabilities and total external debt for 2013/14, reflecting changes to the expected settlement profile of the Crossrail property provision;**
 - (b) **revised Prudential Indicators for 2013/14, as set out in Appendix 1, for Corporation capital expenditure and the Corporation capital financing requirement. These revisions reflect changes to the expected settlement profile of the Crossrail property provision and changes resulting from increased management recharges to subsidiaries. The proposed Indicator for the Group ratio of financing costs to net revenue has also been revised reflecting changed assumptions regarding internal allocations of Transport Grant to revenue versus capital expenditure;**
 - (c) **the TfL Prudential Indicators as set out in Appendix 2 for 2014/15 and the following two years; and**
 - (d) **the Treasury Indicators as set out in Appendix 3 for 2014/15 and the following two years.**

3 Background

- 3.1 The Prudential Code plays a key role in capital finance in local authorities. The Code was developed as a professional code of practice to support Local Authorities in their decision making processes for capital expenditure and its financing.
- 3.2 Local Authorities are required by Regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003 (the Act).
- 3.3 The framework of Prudential Indicators established by the Code aims to ensure that an authority's capital investment plans are affordable, prudent and sustainable. As part of the strategic planning process, authorities are required, on a rolling basis, to calculate a range of indicators for the forthcoming budget year and two subsequent years. Authorities are also required to monitor performance against indicators within the year as well as preparing indicators based on the Statement of Accounts at each year end. Indicators relate to capital expenditure, external debt and treasury management.
- 3.4 The Prudential Code was developed for local authorities in general, the vast majority of which do not have subsidiary companies. The Corporation's proposed Budget and Business Plan have been used to calculate the proposed indicators (see Appendices 1 and 2) as the scope of the Code only extends to the Corporation's accounts and not those of the TfL Group (which consolidates the Corporation and its subsidiary undertakings), as legally the Corporation is the Local Authority.
- 3.5 Although not covered by the Code, equivalent indicators for the Group have been included in Appendices 1 and 2 for information purposes only. Group indicators are provided on a voluntary basis to recognise the unique nature of the TfL Group compared to Local Authorities in general. Group indicators, although voluntary, can provide a better indication of overall performance as they are not affected by some intercompany transactions that can distort the outturn for the Corporation.
- 3.6 The Capital Expenditure and External Debt Indicators relevant to TfL are:
 - (a) Authorised Limit;
 - (b) Operational Boundary; and
 - (c) Capital Financing Requirement;
 - (d) Capital Expenditure; and
 - (e) Ratio of Financing costs to Net Revenue Stream.Definitions for each of these are included in Appendix 4.
- 3.7 The Estimated Incremental Impact of Capital Investment Decisions on Council Tax, although prescribed as an Indicator in the Prudential Code is not relevant to TfL's circumstances and therefore is not included in the calculation of the Corporation's Prudential Indicators.

4 Changes to Prudential Indicators for 2013/14

4.1 Changes to External Debt Limits for 2013/14

4.2 Proposed change to limit for long term liabilities

4.2.1 Prudential Indicators for 2013/14 were approved by the Board in March 2013. A change is proposed to the previously approved limit for total external debt for 2013/14 due to a change in the expected settlement profile of long term Crossrail property claim provisions. The change increases the operational boundary and authorised limit for the Corporation and for the Group by £87.4m (or 1.04 per cent), as shown in the table under 4.3.4. There is no change to the limits for direct borrowings.

4.2.2 Under the Local Government Act 2003, there is an obligation to consult with the London Assembly (the Assembly) on proposals to make in year amendments to the Corporation's borrowing limits, after which approval from the Mayor is sought via a Mayoral Decision. In order to secure an increase in the limit, it has been necessary to consult with the Assembly on the proposed changes in advance of these changes being considered by the Finance and Policy Committee. The last meeting of the Assembly Budget and Performance Committee before the end of the current financial year is 4 March 2014.

4.3 Treatment of PFI liabilities in the calculation of the external debt limits

4.3.1 In setting the direct borrowings element of the authorised limit an allowance was made for the Corporation to refinance certain PFI transactions held as long term liabilities in subsidiary entities as and when it becomes commercially advantageous to do so. The long term liabilities element of the authorised limit for the Group was adjusted down by the same amount to ensure that there was no overall increase in the total authorised limit for the Group.

4.3.2 It is not currently considered likely that the PFI liabilities in question will be refinanced in 2013/14. This will result in outturn long term liabilities for the Group being significantly over the voluntary indicator set, (even after adjusting for the increase in the Crossrail property provision noted in 4.2). However, as the higher expected long term liabilities are offset by lower direct borrowing (reflecting the fact that no refinancing is now expected to take place) these debt reclassifications are not considered to be a matter for concern as they have no net effect on the overall total limit for external debt.

4.3.3 For the voluntary Group indicator, so long as total debt remains within the overall authorised limit, movement may be made between direct borrowings and other long-term liabilities without penalty. TfL is permitted to swap finance lease creditors in subsidiaries for direct borrowing in the Corporation in accordance with its Spending Review 2010 funding agreement with the Secretary of State for Transport. And, given there is no impact on the overall total expected debt from such refinancing, a change to the Group's limit for total external debt is not proposed.

4.3.4 Reconciliation of Changes in External Debt Limits for the Corporation for 2013/14

	Paragraph reference	2013/14 £m
Corporation: Previous Operational Boundary for Gross External Debt		8,369.7
Change in long term liabilities	4.2	87.4
Proposed Operational Boundary for Gross External Debt		8,457.1
Overdraft facility ¹		200.0
Refinancing of PFIs ²	4.3.1	453.0
Refinancing of short term borrowings ³		500.0
Proposed Authorised Limit		9,610.1

Notes

- 1 an overdraft facility is in place to mitigate short term adverse cash flow variances and this is included in the authorised limit
- 2 In setting the Prudential indicators in March 2012 the Board approved an increase in the authorised limit to allow for the refinancing of certain PFI contracts (as permitted in annex C of TfL's SR2013 settlement letter) as and when commercial opportunities arise and value for money can be demonstrated.
- 3 In setting the Prudential indicators in March 2012 the Board also approved an increase in the authorised limit to provide flexibility in refinancing of borrowings, to ensure that the most advantageous rates can be secured.

4.4 Changes to Estimate for Capital Expenditure for 2013/14

- 4.4.1 As set out in Appendix 1, it is proposed that the estimate for capital expenditure for the Corporation for 2013/14 be increased by £403.9m to £3,779.8m from the previous indicator of £3,375.9m. This reflects an increased need for capital grant within London Underground as a result of an increase in their intercompany management fee recharge and intercompany interest capitalised for the first time as a consequence of an accounting policy change. As the changes relate solely to intercompany transactions, they in no way affect the affordability of the Business Plan.

4.5 Changes to Estimate for the Capital Refinancing Requirement for 2013/14

- 4.5.1 As set out in Appendix 1 it is also proposed that the Corporation's capital financing requirement for 2013/14 be increased by £234.4m to £8,513.6m, from the previous indicator of £8,279.2m. This reflects the cumulative impact on both the 2012/13 outturn and the 2013/14 forecast of short - term timing differences in the release of the Corporation's Crossrail property provision as

outlined in 4.2. As the impacts of the timing differences will reverse in the near future, they do not affect the affordability of the Business Plan.

4.6 Changes to Estimate for the Group Ratio of Financing Costs to Net Revenue for 2013/14

4.6.1 It is proposed that the voluntary indicator for the Group's ratio of financing costs to net revenue for 2013/14 be increased to 40.1 per cent from the previous indicator of 37.1 per cent (see Appendix 1). This reflects a greater proportion of Transport Grant income being allocated to capital expenditure rather than revenue expenditure in the 2013/14 forecast.

4.6.2 Although prescribed by the Prudential Code, this indicator is of limited relevance to TfL's particular circumstances as it excludes fare revenues and other income received from the calculation of net revenue, and includes only that portion of Transport Grant allocated by management to Revenue expenditure. It is therefore prone to significant fluctuations between years; and as fares income is excluded the indicator does not truly reflect the affordability of borrowings.

5 Changes to Prudential Indicators for 2014/15 and 2015/16

5.1 Changes to Borrowing Limits for Future Years

5.1.1 Prudential Indicators for the years 2014/15 and 2015/16 were approved by the Board in March 2013. Due primarily to funding changes arising as a result of the 2013 Spending Review the changes to the Corporation's debt limits laid out below in paragraphs 5.1.2 to 5.1.5 and shown in the table under 5.1.6 are proposed. The revised limits are as set out in Appendix 2.

5.1.2 The operational boundary for direct borrowings has been changed in both years, reflecting a revised borrowing profile following the 2013 Spending Review and, as permitted under the 2013 Spending Review, to allow for future scheduled debt repayments to be refinanced if required.

5.1.3 Increases are also proposed to the previously approved operational boundary for long term liabilities due to a change in the expected settlement profile of long term Crossrail property claim provisions as outlined in 4.2 and 4.5.1.

5.1.4 The headroom to the operational boundary and authorised limit for other long term liabilities, allowing for the refinancing of certain PFI contracts, has been reduced from £453m to £424.6m in 2014/15 and 2015/16 in the Corporation, reflecting the reduction in the outstanding liabilities under these contracts since the Prudential Indicators were last set.

5.1.5 For the Group, the reduction to the authorised limit for long term liabilities for the possible refinancing of PFI liabilities has been maintained to avoid double counting these liabilities, as an allowance for the debt has been included within direct borrowings. This means that if the PFI liabilities are not refinanced, the Group will exceed its indicator for the long term liability segment of its authorised debt; but will remain within it for total external debt. As the Group indicators are voluntarily included for information purposes only,

and as movement may be made between direct borrowings and other long-term liabilities without penalty, so long as the overall total for external debt is not affected, this is not considered to be a matter for concern.

5.1.6 Reconciliation of Changes in External Debt Limits for the Corporation for 2014/15 to 2016/17

	Paragraph reference	2014/15 £m	2015/16 £m	2016/17 £m
Corporation: Previous Operational Boundary for Gross External Debt		8,933.0	9,405.8	N/A
Changes due to re-profiling of debt following Spending Review	5.1.2	(22.1)	78.8	N/A
Change in long term liabilities	5.1.3	54.0	12.3	N/A
Proposed Operational Boundary for Gross External Debt		8,964.9	9,497.0	10,199.3
Overdraft facility ¹		200.0	200.0	200.0
Refinancing of PFIs ²	5.1.4	424.6	424.6	424.6
Refinancing of short term borrowings ³		500.0	500.0	500.0
Proposed Authorised Limit		10,089.5	10,621.6	11,323.9

Notes

- 1 an overdraft facility is in place to mitigate short term adverse cash flow variances and this is included in the authorised limit
- 2 In setting the Prudential indicators in March 2012 the Board approved an increase in the authorised limit to allow for the refinancing of certain PFI contracts (as permitted in annex C of TfL's SR2013 settlement letter) as and when commercial opportunities arise and value for money can be demonstrated.
- 3 In setting the Prudential indicators in March 2012 the Board also approved an increase in the authorised limit to provide flexibility in refinancing of borrowings, to ensure that the most advantageous rates can be secured.

5.2 Changes to Other Prudential Indicators for 2014/15 and 2015/16

- 5.2.1 The other prudential indicators for 2014/15 and 2015/16 for the Corporation and Group have also been amended as a result of the changes arising from the 2013 Spending Review to the Budget (included in this meeting agenda) and Business Plan (as approved by the Board in December 2013). The tables in Appendix 2 set out these revised indicators.

6 Prudential Treasury Indicators

- 6.1 A number of treasury indicators that historically formed part of the Prudential Code are now presented by CIPFA LASAAC as treasury management indicators required by the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (the TM Code). Local authorities are required to “have regard” to these treasury indicators.
- 6.2 Following developments in the market place and the introduction of the Localism Act 2011, CIPFA published an updated TM Code in November 2011 with revised guidance in relation to the management of derivatives. The proposed treasury indicators, however, remain unchanged and are detailed in Appendix 3. They comprise:
- (a) upper limits on fixed interest and variable interest exposures;
 - (b) upper and lower limits on the maturity structure of borrowing; and
 - (c) upper limits to the total of principal sums invested longer than 364 days.

6.3 Composition of the Proposed Borrowing Limits for 2014/15

- 6.3.1 The composition of the borrowing limits is set out in the proposed Treasury Management Strategy (TMS), which is being considered in a separate paper to this meeting. It is expected that the Mayor will have consulted with TfL by the time of the 26 March Board meeting which will allow the Board to adopt the in-year Authorised Limit for external debt as above, which includes direct borrowings of £9,776.5m in 2014/15 as set out in Appendix 2.

7 Views of the Finance and Policy Committee

- 7.1 At its meeting on 12 March 2014, the Finance and Policy Committee considered a similar paper and endorsed the recommendations to the Board.
- 7.2 Since the meeting of the Committee, a minor correction has been made to Appendix 2, Operational Boundary for External Debt, TfL Corporation, to correct the figure for PFI and long term liabilities in the Proposed Revised Indicator Plan 2016-17 column. No change was required to any other figures.

List of appendices to this report:

Appendix 1: TfL Prudential Indicators for 2013/14
Appendix 2: TfL Prudential Indicators for 2014/15 to 2016/17
Appendix 3: Treasury Management Indicators
Appendix 4: Definitions for Prudential Indicators

List of Background Papers:

None

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Appendix 1

THE PRUDENTIAL INDICATORS FOR 2013/14 TRANSPORT for LONDON

	Paragraph reference	Original Indicator 2013 - 14 £millions	Movement £millions	Proposed Revised Indicator 2013 - 14 £millions
<u>Operational Boundary for External Debt*</u>				
TfL Corporation				
Borrowing		8,024.0	-	8,024.0
PFI and long term liabilities		345.7	87.4	433.1
Total Operational Boundary for External Debt in TfL Corporation	4.2	8,369.7	87.4	8,457.1
TfL Group				
Borrowing		8,024.0	-	8,024.0
PFI and long term liabilities	4.2	1,122.8	87.4	1,210.2
Total Operational Boundary for External Debt TfL Group		9,146.8	87.4	9,234.2
<u>Authorised Limit for External Debt**</u>				
TfL Corporation				
Borrowing		9,177.0	-	9,177.0
PFI and long term liabilities	4.2	345.7	87.4	433.1
Total Authorised Limit in for External Debt in TfL Corporation		9,522.7		9,610.1
TfL Group				
Borrowing		9,177.0	-	9,177.0
PFI and long term liabilities	4.2	696.2	87.4	783.6
Total Authorised Limit for External Debt in TfL Group		9,873.2	87.4	9,960.6
<u>Estimates of Capital Expenditure (Annual)</u>				
TfL Corporation	4.4	3,375.9	403.9	3,779.8
TfL Group		3,797.2	-	3,797.2
<u>Estimates of Capital Financing Requirement (Cumulative)***</u>				
TfL Corporation	4.5	8,279.2	234.4	8,513.6
Total TfL Group		9,688.1	-	9,688.1

* The Operational Boundary is a calculation based upon the cash flows in the Budget and Plan. If breached, it is a warning that financial plans may require review and amendment.

** The Authorised Limit is the maximum amount that TfL may borrow legally.

*** The Capital Financing Requirement is the amount of capital expenditure to be financed by means other than grant or asset sales proceeds.

Prudential Indicators for Prudence and Affordability				
	Paragraph reference	Original Indicator 2013 - 14	Movement	Proposed Revised Indicator 2013 - 14
<u>Estimates of ratio of financing costs to net revenue stream</u>				
TfL Corporation		20.0%	-%	20.0%
TfL Group	4.6	37.1%	3.0%	40.1%

The Prudential Code requires information in respect of TfL Corporation and also requires the effect of subsidiaries to be taken into account. Accordingly, Group figures are also stated.

Appendix 2

THE PRUDENTIAL INDICATORS FOR 2014/15 TO 2016/17 TRANSPORT for LONDON

	Paragraph reference	Proposed Revised Indicator Budget 2014 - 15 £millions	Proposed Revised Indicator Plan 2015 - 16 £millions	Proposed Revised Indicator Plan 2016 - 17 £millions
<u>Operational Boundary for External Debt*</u>				
TfL Corporation				
Borrowing	5.1.2	8,651.9	9,251.9	9,951.9
PFI and long term liabilities	5.1.3,5.1.4	313.0	245.1	247.4
Total Operational Boundary for External Debt in TfL Corporation		8,964.9	9,497.0	10,199.3
TfL Group				
Borrowing	5.1.2	8,651.9	9,251.9	9,951.9
PFI and long term liabilities	5.1.3,5.1.4	1,037.6	878.8	781.7
Total Operational Boundary for External Debt TfL Group		9,689.5	10,130.7	10,733.6
<u>Authorised Limit for External Debt**</u>				
TfL Corporation				
Borrowing		9,776.5	10,376.5	11,076.5
PFI and long term liabilities		313.0	245.1	247.4
Total Authorised Limit in for External Debt in TfL Corporation		10,089.5	10,621.6	11,323.9
TfL Group				
Borrowing		9,776.5	10,376.5	11,076.5
PFI and long term liabilities	5.1.5	643.1	524.2	470.0
Total Authorised Limit for External Debt in TfL Group		10,419.6	10,900.7	11,546.5
<u>Estimates of Capital Expenditure (Annual)</u>				
TfL Corporation	5.2	4,853.6	3,313.9	3,555.0
TfL Group	5.2	4,566.7	4,438.2	3,832.4
<u>Estimates of Capital Financing Requirement (Cumulative)***</u>				
TfL Corporation	5.2	9,399.1	9,960.4	10,633.6
Total TfL Group	5.2	10,017.8	10,474.1	11,095.8

* The Operational Boundary is a calculation based upon the cash flows in the Budget and Plan. If breached, it is a warning that financial plans may require review and amendment.

** The Authorised Limit is the maximum amount that TfL may borrow legally.

*** The Capital Financing Requirement is the amount of capital expenditure to be financed by means other than grant or asset sales proceeds.

Prudential Indicators for Prudence and Affordability

<u>Estimates of ratio of financing costs to net revenue stream</u>	Paragraph reference	Proposed Revised Indicator Budget 2014 - 15	Proposed Revised Indicator Plan 2015 - 16	Proposed Revised Indicator Plan 2016 - 17
TfL Corporation	5.25.2	58.9%	35.5%	24.8%
TfL Group	5.2	135.7%	81.3%	57.1%
Gross Debt and the Capital Financing Requirement*			TfL Group**	Corporation
			£millions	£millions
Gross Debt at 31 March 2015			10,419.6	10,089.5
Capital Financing Requirement at 31 March 2017			11,095.8	10,633.6

* The Prudential Code stipulates that Gross Debt at 31 March 2015 should not generally exceed the Capital Financing Requirement at 31 March 2017.

**The Prudential Code requires information in respect of TfL Corporation and also requires the effect of subsidiaries to be taken into account. Accordingly, Group figures are also stated.

Prudential Indicators for Treasury Management

Interest Rate Exposures

Borrowing upper limit – fixed
 Borrowing upper limit – variable
 Investments upper limit – fixed
 Investments upper limit – variable

Budget	Plan	Plan
31 Mar 15	31 Mar 16	31 Mar 17
100%	100%	100%
50%	50%	50%
50%	50%	50%
100%	100%	100%

If this indicator is broken it serves as a warning to management that the interest rate risk strategy is not being adhered to.

Maturity Structure of Borrowing

< 1 year
 1 year to < 2 years
 2 years to <5 years
 5 years to <10 years
 10 years and above

Budget	
31 Mar 15	
Upper	Lower
35%	0%
35%	0%
50%	0%
75%	0%
100%	20%

This indicator represents limits (for fixed rate debt) of the percentage of borrowing maturing in the future periods above as a total of fixed rate borrowing outstanding.

Actual amounts will depend on the projects financed and which ones have been converted into long-term obligations

Maximum Outstanding Principal sum Invested for more than 364 days

Forward Financial Year 1
Forward Financial Year 2
Forward Financial Year 3
Forward Financial Year 4

Budget	Plan	Plan
31 Mar 15	31 Mar 16	31 Mar 17
£millions	£millions	£millions
1,500	1,500	1,500
1,000	1,000	1,000
750	750	750
500	500	500

Definitions for Prudential Indicators used by TfL

1. External Debt - Operational Boundary
 - The Operational Boundary is a sum of external borrowings and long term capital liabilities, including finance lease creditors and provisions, as shown in the Budget and Plan. If breached, it is a warning that financial plans may require review and amendment.
2. External Debt - Authorised Limit
 - The authorised limit is the maximum amount that TfL may borrow legally.
 - It is comprised of the Operational Boundary plus an element of headroom to allow for unexpected cashflow fluctuations.
3. Capital Expenditure
 - For the Group this is the total of fixed asset additions for the given period.
 - For the Corporation this is the Corporation's own fixed asset additions plus any loans or capital grants passed to the subsidiaries for the given period.
4. Capital Financing Requirement
 - The Capital Financing Requirement (CFR) is the amount of capital expenditure to be financed by means other than grant or asset sales proceeds. It is calculated from the balance sheet of the Group and Corporation by deducting deferred grant, and capital reserve balances from the total fixed asset balance.
 - There is a requirement in the Code to ensure that the estimate for the CFR at the end of 2017 is not exceeded by gross debt budgeted at the end of 2015. This requirement seeks to ensure that over the medium term, debt will only be for a capital purpose.
5. Ratio of financing costs to net revenue streams
 - Indicator expresses the interest costs, net of interest income as a percentage of TfL's Revenue Grant plus or minus transfers to reserves.